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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. [redacted] 93

CHARLES J. McCOLGAN, Franchise Tax Commissioner of the State of California,
Petitioner,

vs.

MAIER BREWING COMPANY, a corporation, and H. F. METCALF, Trustee of the Estate of Maier Brewing Company, Debtor,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

ROBERT W. KENNY,
Attorney General of the State of California,

HARTWELL H. LINNEY,
Assistant Attorney General,
Attorneys for Petitioner.

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Charles J. McColgan, Franchise Tax Commissioner of the State of California, respectfully prays that a writ of certiorari issue to review

the judgment of the United States Circuit Court of Appeals for the Ninth Circuit, entered in the above entitled cause on March 10, 1943, affirming the judgment of the United States District Court for the Southern District of California, Central Division.

OPINION BELOW

The opinion of the Circuit Court of Appeals is reported in 134 Fed. (2d) 385, and will be found in the Record herein at page 182.

JURISDICTION

The judgment sought to be reviewed was entered on March 10, 1943. The jurisdiction of this court is invoked under section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether, under section 124(a), 28 U.S.C.A., a state may acquire, pursuant to its own statutes, a lien for state taxes on property in the hands of a Receiver appointed by a District Court of the United States following the filing of an involuntary petition in bankruptcy, said Receiver being authorized by the court to carry on the business of the alleged bankrupt and actually operating said business.

2. Whether, under the facts shown by the record herein the court below was justified in its conclusion that the State Franchise Tax Commissioner

knew or should have known that the Receiver was operating the business, notwithstanding the Receiver's neglect to file returns and his statements that "In Bankruptcy Receivership—no business transacted."

3. Whether, under the facts shown by the record herein the court below was justified in holding the Commissioner's tax claim was "stale."

4. Whether the court below, under the facts shown by the record herein, was justified in denying petitioner's claim for taxes for the years 1934, 1935, 1937 and 1938, amounting with interest and penalties to $8,858.19, assessed against respondent corporation by reason of the net income from operations by the Receivers in those years.

5. Whether the court below erred in holding that section 124(a), 28 U.S.C.A., does not in terms or by implication impair the principle that property in the custody of the bankruptcy court may not be subjected to liens while so held.

(Note: After termination of the receiverships, the properties were returned to respondent corporation in 1939 and thereafter were operated by the corporation until the appointment in December, 1940, of a trustee in the present Chapter X proceeding.)

STATUTES INVOLVED

The statutes involved will be found in the Appendix hereto.

STATEMENT

(a) Facts in Bankruptcy Petition No. 18884-H

In June, 1932, an involuntary Petition in Bankruptcy was filed against Maier Brewing Company, No. 18884-H.

Myron H. Wells was appointed Receiver with authority to manage, control and operate the business and property of the alleged bankrupt (Tr. 88), and did so operate the business until July 10, 1935, at which time his resignation was accepted and Philip L. Wilson was appointed Receiver in his place with the same powers. Wilson operated the business until September 10, 1938 (Tr. 90).

During Wells' operation of the business franchise taxes were assessable under the Bank and Corporation Franchise Tax Act (Stats. 1929, page 19, as amended) for the years 1934 and 1935, based on net income for the preceding years.

It was stipulated by counsel in the proceedings before the special master that the amount of taxable income as the basis for the tax in 1934 was $75,018.32, and for the tax in 1935 was $34,157.49. (Tr. 100.) Federal taxes were paid by Wells on the above bases.

While filing federal returns and paying large sums as taxes Wells for some reason not clearly disclosed but presumably on the advice of counsel apparently considered that no taxes were payable to the State on the net income of his operations. He did pay the minimum tax of $25.00. On February

23, 1933, Wells wrote the Franchise Tax Commissioner a letter which is set forth in full at page 93 of the Transcript.

On March 12, 1934, Wells sent the Commissioner a check for $25 accompanied by a verified return in blank, across the face of which was written:

> "Corporate powers suspended by the United States District Court, Southern District of California, Central Division, in Re Maier Brewing Company, No. 18884-H, Myron H. Wells, Receiver in Bankruptcy." (Tr. 94.)

Under section 124, U.S.C.A. he should have made a return reporting net income as was done with the federal government.

On September 5, 1934, Wells wrote the Commissioner as follows:

> "Please advise me the amount of franchise tax owing by the Maier Brewing Company. This company has been in receivership since June, 1932, *and no operations have been carried on by the corporation.*" (Emphasis supplied). (Tr. 94.)

To this letter the Commissioner replied:

> "Tax liability *of record of the subject corporation* for the taxable year ending December 31, 1934, *as disclosed by return of operations filed for the taxable year ended December 31st, 1933,* has been entirely satisfied." (Emphasis supplied.) (Tr. 95.)

This letter was, of course, based on Wells' return of March 12, 1934, above referred to, and had no

connection with any possible liability of Wells for his operations as receiver.

On January 10, 1935, Wells filed a verified return in blank except for the notation "In Bankruptcy Receivership No Business Transacted (Tr. 95).

On February 12, 1935, Wells wrote the Commissioner as follows (Tr. 95):

> "In answer to your demand for supplemental data, dated February 11, I am the Federal Receiver in Bankruptcy of the Maier Brewing Company and was, during all of the calendar year 1933.
>
> *I am not operating the corporation* and the Maier Brewing Company's corporate powers were suspended at the date of my appointment." (Emphasis supplied.) (Tr. 95.)

It is thus clear that the Receiver made no disclosure at any time to the Commissioner covering his activities in operating the business and completely failed to report the income therefrom or to pay any taxes in connection therewith to the State although in 1934 and 1935 he paid large sums as taxes to the federal government. The returns, such as they were, were corporate returns and not returns of his own activities as Receiver.

Receiver Philip L. Wilson, appointed on July 10, 1935, continued to operate the business down to September 10, 1938, a period of more than three years, apparently without making any State returns

whatever although federal returns were made and taxes paid on net income in the following amounts:

Tax year	*Amount of Taxable Income*
1937	$41,859.98
1938	58,231.43 (Tr. 100)

All of Receiver Wilson's operations were carried on while section 124a, 28 U.S.C.A. was in force. He filed the Eighteenth and Final Report which was approved by the court on October 4, 1938 (Tr. 90).

The special master stated in his report (Tr. 91) that in Wilson's final report there was no mention of any obligation for franchise taxes to the State.

In March of 1939 the petition in bankruptcy was dismissed, the proceedings terminated and the property restored to the company (Tr. 91) which operated it until December 4, 1940, when the present proceedings commenced (Tr. 99).

The special master calls attention to the fact that in proceeding No. 18884 various notices to creditors were published in Los Angeles papers (Tr. 91) and to the testimony given at the hearing before him by Mr. Bondeson (Tr. 98) and concluded that the Commissioner had notice of the receivership proceedings in case No. 18884 and of the fact that the respective receivers were operating the business and property of the Maier Brewing Company.

His conclusion was based upon "the foregoing oral and documentary evidence." (Tr. 98-99.)

The oral evidence was the testimony given by Mr. Bondeson, Deputy Commissioner, and the docu-

mentary evidence presumably included the Receiver's letters and returns and the published notices to creditors. The trial court approved the findings of the special master except that the court stated:

> "Accordingly, I have concluded that Mr. Bondeson did not have personal notice that the receiver of the debtor was operating its business during any portion of the period that the receivership was in effect." (Tr. 132.)

The only basis for the court's conclusion, that the Commissioner had notice, therefore, was the documentary evidence consisting of letters, the so-called returns and the published notices.

No obligations for the payment of franchise taxes to the State of California were listed by receiver Wilson in his final report in No. 18884 (Tr. 91).

(b) Facts in Bankruptcy Petition No. 37544-H, Now Pending in the United States District Court

Pursuant to a Petition by creditors of Maier Brewing Company, a corporation, for approval of a plan of reorganization (Tr. 2) the District Court, on December 19, 1940, made an order approving the petition and appointing Frank C. Mortimer as Trustee of the Estate of Maier Brewing Company and Ed R. Maier as Additional Trustee, said appointments not to be effective until December 28, 1940. This proceeding is numbered 37544-H.

On February 7, 1941, appellant filed a claim for taxes against said debtor corporation pursuant to

the Bank and Corporation Franchise Tax Act, in the aggregate amount of $10,182.54 (Tr. 36), the items comprising said amount being set forth in the transcript at pages 38-40.

Thereafter the Commissioner filed an amendment to his claim in which he set forth that the taxes for the years 1934 and 1935 were a lien on *all* property of the debtor and the taxes for the years 1937, 1938, 1939 and 1940 were a lien on the *real* property of the debtor (Tr. 115).

Thereafter Trustee Mortimer filed his objections to appellant's claim (Tr. 40), and the debtor corporation also filed its objections to said claim (Tr. 45-80).

On May 16, 1941, the court made an order of reference to a special master (Herman A. Backrack) to hear the objections (Tr. 81) and on October 6, 1941, the special master made his report (Tr. 85-126).

The special master's report recommended the allowance of appellant's claim in the sum of $1,324.35, and recommended disallowance of all of appellant's claim over and above that amount (Tr. 113).

Appellant duly filed his objections to the special master's report (Tr. 127) and on March 3, 1942, the court re-opened the proceedings and permitted further testimony to be taken with a view to explaining certain testimony given at the hearing before the special master (Tr. 155).

Thereafter, on May 21, 1942, the court filed a memorandum of its conclusions in respect to the objections to the special master's report and therein referred to the additional evidence presented in open court on March 3, 1942 (Tr. 155) and in that memorandum the court said:

> "During the taking of this additional evidence, the witness was subjected to a searching cross-examination. I am now satisfied that he did not intend to answer the aforementioned questions in the manner in which he did before the Special Master. Accordingly, I have concluded that Mr. Bondeson did not have personal notice that the receiver of the debtor was operating its business during any portion of the period that the receivership was in effect.
>
> In all other respects, however, I am satisfied that the record supports the findings of fact as reported by the Special Master." (Tr. 132.)

The District Court then made an order reading as follows:

> "For the reasons set forth in the Memorandum of Conclusions this day filed, it is ordered that the claim of the Franchise Tax Commissioner of the State of California be allowed as a preferred claim only in the sum of $1,324.35, plus interest as prayed for, and that all of the remainder of said claim be disallowed."

From this order an appeal was taken to the Circuit Court of Appeals for the Ninth Circuit, and that court on March 10, 1943, affirmed the District

Court. This petition for writ of certiorari is to secure a review of the last-mentioned judgment.

GROUNDS ON WHICH THE DECISION OF THE COURT BELOW RESTS

The Circuit Court of Appeals for the Ninth Circuit apparently based its decision upon the following grounds:

1. That the claim of the Franchise Tax Commissioner was barred by failure seasonably to present it. (The court did not say in so many words that the claim was barred by the statute of limitations contained in the Bank and Corporation Franchise Tax Act, but such may be inferred from the court's opinion (R., p. 182, at p. 186).)

2. That state statutes imposing liens for taxes on property of the taxpayer are set aside and rendered inapplicable where the property is in the hands of a Receiver, appointed by a United States District Court, who is operating the taxpayer's business and who is, therefore, governed by the provisions of section 124(a), 28 U.S.C.A. In other words, that a lien for state taxes may not attach to a taxpayer's property while the Receiver is in charge and operating the property for the benefit of the taxpayer and its creditors.

3. That the so-called "returns" filed by the Receiver were sufficient to put the Franchise Tax Commissioner on notice that the Receiver was operating the business and therefore were sufficient to start the running of the statute of limitations.

4. Assuming, as the court did, that the Commissioner was guilty of laches, that such laches was imputable to the State in its sovereign capacity and rendered the State's claim for taxes "stale."

5. That the equities of the State's situation were less than those of creditors in the plan of composition effected in 1938, and less than those of creditors in the pending proceeding, which creditors the court said "can hardly escape prejudice if this stale claim were now to be allowed." (R., p. 182, at p. 189.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals for the Ninth Circuit erred:

1. In holding that a state statute imposing liens for taxes on property of a corporate taxpayer is set aside and made inapplicable where the property is in the hands of a Receiver who is operating the taxpayer's business, notwithstanding the provisions of section 124(a), 28 U.S.C.A.

2. In holding that the claim of the State of California was barred by failure seasonably to present it.

3. In holding that the so-called "returns" filed by the Receiver (containing no information respecting his operation of the business and no information respecting the net income therefrom, but indicating that he was not operating the business) were sufficient to start the running of the statute of limitations, contrary to the provisions of the taxing act.

4. In holding that the alleged laches of the Franchise Tax Commissioner was imputable to the State

in its sovereign capacity and rendered the State's claim "stale."

5. In holding that the equities of the State's situation were less than and subordinate to the assumed equities of creditors in the plan of composition effected in 1938 (in no way involved herein), and less than and subordinate to the assumed equities of creditors in the pending proceeding (there being no evidence or finding that the respondent corporation is insolvent or unable to pay the State's claim as well as the claims of all other creditors in the pending proceeding).

6. In holding that the State was not entitled to recover, or to have allowed as a claim in the pending proceeding, the sum of $8,858.10, representing taxes, penalties and interest assessed under authority of the Bank and Corporation Franchise Tax Act and section 124 (a), 28 U.S.C.A., measured by the net income of the Receivers from operation of the taxpayer's business.

REASONS FOR GRANTING THE WRIT

We respectfully represent the writ should be granted because:

1. The decision herein conflicts with the decision of this court in *Boteler* v. *Ingels,* 308 U. S. 57, and with the lower court's own decision in that case, reported at 100 Fed. 2d 915, and with the same court's decision in *State* v. *Hisey,* 84 Fed. 2d 802.

The Ninth Circuit Court in the instant case said, referring to section 124 (a), 28 U.S.C.A., that:

> "The statute does not in terms or by implication impair the principle that property in the custody of the bankruptcy court may not be subjected to liens while so held."

The only case cited was *Straton* v. *New,* 283 U. S. 318, 321.

While it is true that in *Straton* v. *New* this court said that from the filing of the petition in bankruptcy the estate is regarded as *in custodia legis* and thereafter liens cannot be obtained nor proceedings had *in other courts* to reach the property, we respectfully submit that this was *dicta* because the liens there involved had accrued sixteen months prior to the filing of the petition in bankruptcy.

It was held that the bankruptcy court had no power to enjoin proceedings in a state court to enforce the liens. There was no mention of section 124 or 124(a). In fact, the latter section was not then in existence.

It seems clear, therefore, that *Straton* v. *New* does not support the lower court's conclusion. In any event, it appears from the cases cited by the court at page 321 that the extent of the holding was that while the property of the estate was *in custodia legis* in a certain court sitting in bankruptcy, liens could not be obtained nor proceedings had *in other courts* to reach the property. In each of the following cases cited by this court at page 321, the hold-

ing was that the court of original jurisdiction had exclusive control of the estate and that *other courts* would not interfere.

Murphy v. *John Hoffman Co.,* 211 U. S. 562;
U. S. Fidelity Co. v. *Bray,* 225 U. S. 205;
Hebert v. *Crawford,* 228 U. S. 204;
Lazarus v. *Prentice,* 234 U. S. 263.

Here, of course, no court except the court of original jurisdiction is involved, and in that court Petitioner is seeking the relief by way of lien which is accorded it by the State statute.

Section 124(a), 28 U. S. C. A., provides in part:

> "Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to such business *the same as if such business were conducted by an individual or corporation.*" (Emphasis added.)

This section has been construed in at least two cases by this court. The first case was *Boteler* v. *Ingels,* 308 U. S. 57, on certiorari to the Ninth Circuit Court of Appeals.

In that case penalties were involved incurred by a Receiver operating under section 124(a). The penalties were imposed under the state statute, but it was contended by the respondent that the allowance of such penalties was prohibited by section 57(j) of the Bankruptcy Act. In disposing of this

contention this court, at page 60, referred to the legislative history of section 124(a) and remarked that it indicated "a congressional purpose to facilitate—not to obstruct—enforcement of state laws, the court below correctly recognized and applied this congressional purpose and its judgment is affirmed."

In the instant case the court below failed to recognize or apply the congressional purpose and consequently rendered an erroneous decision which can be reversed only through the granting of certiorari herein.

The imposition of penalties is one "traditional and almost universal method of enforcing prompt payment" of taxes. Another method of enforcing payment of taxes, also traditional and almost universal, is to support the same by statutory liens. Here the State statute provides for a lien, but the court below held that it does not attach because the property was *in custodia legis.*

The second case decided by this court which construed section 124 (a) was *Palmer* v. *Webster & Atlas Bank,* 312 U. S. 156. In that case this court, referring to the act adopting section 124 (a), said at page 163:

> "The legislative history of the Act discloses its purpose. The committee reports accompanying the bill which became the Act of 1934 state: 'The purpose of this bill is to subject businesses conducted under receivership in Federal courts to State and local taxation the same as if such

businesses were being conducted by private individuals or corporations.' The reports advert to the fact that federal courts had held a federal receiver operating a business exempt from state sales taxes. They conclude: 'No good reason is perceived why a receiver should be permitted to operate under such an advantage as against his competitors not in receivership, and the States and local governments be deprived of this revenue.'

What Congress intended was that a business in receivership, or conducted under court order, should be subject to the same tax liability as the owner would have been if in possession and operating the enterprise.''

Neither in the *Boteler* case nor in the *Palmer* case did this court even suggest any qualification or interpretation of section 124 (a) such as the lower court here introduced. The section, as we interpret it, and as this court apparently has interpreted it in the two cases above referred to, permits State law the *same operation and effect* as applied to an operating receiver as to an operating corporation. But the court below makes an important distinction. That court holds that the law which gives the state a lien for taxes against the property of an operating corporation *does not* give the state a lien against the property in the custody of an operating receiver.

This distinction, we submit, is not founded on anything in the section itself or in any case construing it, but merely rests upon some idea now entertained by the court that property in the cus-

tody of a bankruptcy court is somehow sacred and inviolable, notwithstanding the fact that the property is being actively employed and used by the court-appointed receiver in the same manner that it was formerly employed and used by its corporate owner.

The court's decision construed section 124 (a) in a way which obstructed the purpose of Congress instead of facilitating that purpose. This court, in the *Boteler* case, said that the purpose of Congress in enacting section 124 (a) was "to facilitate—not to obstruct—enforcement of State laws."

State law is not enforced when the court refuses to apply the law and says there is no lien when the statute positively and expressly provides a lien. Section 29 of the Bank and Corporation Franchise Tax Act as it read in 1934, when the first tax lien accrued, read:

> "The taxes levied under this act shall constitute a lien upon all property of the taxpayer, which lien shall attach on the first Monday in March of the year in which the taxes accrue . . . Every tax herein provided for has the effect of a judgment against the taxpayer, and every lien has the effect of an execution duly levied against all property of the delinquent, and the judgment is not satisfied nor the lien removed until the tax and the penalty are paid, or the property sold for the payment thereof . . ." (Stats. 1933, p. 692, at 703.)

Section 29 was amended in 1935 (Stats. 1935, p. 959, at 979) and the lien provision remained substantially as before except that it was provided that the lien should attach "on the first day of the 'taxable year'."

Section 29 was again amended in 1937 (Stats. 1937, p. 2324, at 2344). The only material change so far as we are here concerned was that the tax was made a lien upon real property only, instead of upon all property of the taxpayer.

It will thus be seen that the taxes for the 1934 and 1935 taxable years were a lien upon *all* the property of the corporation, while the taxes for 1937 and 1938 were a lien only on the corporation's real property.

Under the decisions of this court in the *Boteler* and *Palmer* cases, *supra,* it was the duty of the court below to apply the State statutes above referred to and to hold that liens for the taxes attached to respondent corporation's property as follows:

1934-1935 taxes on all such property;
1937-1938 taxes on all the real property.

Since returns were not filed by the two Receivers as required by the act, it was the further duty of the court below to apply the provisions of the act and to hold that the assessments later made by the Commissioner were not barred (section 16), and that the statutory liens were not discharged (section 29).

Receiver Wilson made no attempt at all to file returns for the years 1937 and 1938 and did not mention State taxes in his final report. Nevertheless the courts below held, contrary to the plain provisions of the act, that taxes for these years also were barred.

The mandate of section 124(a) that the Receiver shall be subject to taxation "the same as if such business were conducted by an individual or corporation" was ignored by the court below on the sole authority of *Straton* v. *New, supra,* which was decided prior to the enactment of section 124(a).

This error can not be corrected unless this court grants the petition herein.

The interpretation given by us to section 124(a) is, we believe, fully approved and adopted by the Supreme Court of California in *Fifth Street Building* v. *McColgan,* 19 Cal. (2d) 143, at 145, and by the respective courts, including this court, which decided the cases cited in the quotation below.

At page 145 of the case above mentioned the court said, referring to section 124(a):

> "This language envisages precisely such situations as the present one. The trustee, appointed after June 18, 1934, by a United States court, conducted the business theretofore carried on by Walkers Inc., then subject to the franchise tax as it would have continued to be had it not gone into bankruptcy. The Act of Congress makes it clear that the appointment of a trustee in bankruptcy by a federal court does not relieve a business of the state and local taxes to which it

is normally subject. 'What Congress intended was that a business in receivership or conducted under court order, should be subject to the same tax liability as the owner would have been if in possession and operating the enterprise.' (*Palmer* v. *Webster & Atlas Nat. Bank* v. *Boston,* 312 U. S. 156 (61 Sup. Ct. 542, 545, 85 L. Ed. 642); see also, *Philadelphia Co. et al.* v. *Dipple,* 312 U. S. 168 (61 Sup. Ct. 538, 85 L. Ed. 651); *Boteler* v. *Ingels,* 308 U. S. 57 (60 Sup. Ct. 29, 84 L. Ed. 78); *Thompson* v. *Louisiana,* 98 Fed. (2d) 108; *In re Vicksburg Bridge & Terminal Co.,* 24 Fed. Supp. 123; *International Shoe Co.* v. *Pickard & Geismar,* 30 Fed. Supp. 570; *In re Kentucky Fuel Gas Corp.,* 37 Fed. Supp. 625; *The Southern Cross,* 120 Fed. (2d) 466.)"

This court denied certiorari (316 U. S. 648).

It was settled in *Boteler* v. *Ingels, supra,* not only that a trustee in bankruptcy comes within the meaning of the Act of Congress and can not therefore escape the applicability of a state tax, but that the trusteeship can in no way militate against *the effective enforcement of the tax.* (Italics supplied.)

This petition and supporting brief is already longer than we intended, for which we offer our apologies to the court, and therefore we will not discuss in detail the further errors of the lower court which have been referred to herein. These errors were cumulative in effect and were the outgrowth of the court's primary error respecting the construction of section 124(a) in regard to the State's lien for the taxes.

We respectfully pray that the Writ of Certiorari be granted.

Dated: May 24, 1943.

ROBERT W. KENNY,
Attorney General of the
State of California,

HARTWELL H. LINNEY,
Assistant Attorney General,
Attorneys for the Petitioner.